BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE NEBRASKA PUBLIC SERVICE COMMISSION, ON ITS OWN MOTION, SEEKING TO ESTABLISH A LONG-TERM UNIVERSAL SERVICE FUNDING MECHANISM	APPLICATION NO. NUSF-26

QWEST CORPORATION'S REPLY COMMENTS TO PROGRESSION ORDER NO. 4.

The Nebraska Public Service Commission ("Commission") entered progression order number 4 (the "Order") in the above-captioned docket on January 7, 2003, identifying issues for comment for the interested parties to file comments. Those comments were filed on March 10, 2003. Qwest Corporation ("Qwest") hereby submits its reply comments, as solicited by the Commission.

INTRODUCTION

Because the Order was not specific regarding a number of issues, interested parties offered a wide variety of comments and proposals. In these comments, Qwest specifically replies to many of the parties' comments. Qwest's overriding concerns, however, are that the Commission creates a high cost mechanism that favors no particular class of carrier, encourages fair competition in all regions of Nebraska, prevents double support from Federal and State sources, and is simple to implement and administer.

MODELS AND INPUTS

Qwest emphasizes that it neither sponsors nor endorses the HAI model. HAI is a product of AT&T's UNE advocacy that seeks to lower rates. Each successive version of HAI has generated lower cost estimates, and if the current version of HAI had been released in the late 1990's, it probably would have been dismissed as ridiculous. In the very limited scope of the Order, however, Qwest does not actively oppose its use. This is because HAI is not to be used to directly assign costs to ILECs, but rather HAI will be used to develop relative costs among regions of various customer densities.

On page 2 of his comments, Dr. Rosenbaum suggests that HAI version 5.2a should be used instead of HAI version 5.0a. Qwest recommends caution in the assumption that 5.2a is simply an improved version of 5.0a. HAI 5.2a is a radical departure from 5.0a both in terms of its results, which vary widely, and in the data and algorithms employed. 5.2a uses different, but not necessarily newer or better, customer location data. 5.2a also uses very different cable routing algorithms. Without the benefit of a fully contested hearing on the merits of HAI 5.2a, Qwest objects to its adoption. In any event, a simple one sentence suggestion is not sufficient cause to substitute 5.2a for 5.0a.

Dr. Rosenbaum's support for a common set of model inputs is correct. In addition to Qwest's arguments about economic efficiency, Dr. Rosenbaum argues that a single input set "will result in a more reasonable, more accurate cost function result."

Dr. Rosenbaum, on page 4 of his comments, does suggest the possibility of adjusting model inputs based on company size. Qwest is doubtful of the benefits of pursuing these adjustments, but it does support Dr. Rosenbaum's suggestion that any such adjustments should be the result of a thorough hearing. The issue of whether such adjustments are appropriate, and if so, what adjustments should be made, is complicated and warrants a separate proceeding.

Alltel's comments suggest that HAI 5.0a has serious flaws. Notably, HAI is unproven for rural LECs and its default inputs are biased to create unreasonably low UNE rates. While both of these assertions are true, Qwest recommends against undue concern. Qwest is not aware of any forward looking model that has been validated for rural LECs; the popular models should work the same for all LECs, however the customer location data for rural LECs is largely untested. Even so, the alternative to a forward looking model, embedded accounting data, is far worse than HAI, especially for rate of return regulated LECs[1]. As Qwest stated in its prior comments, embedded data will reward inefficient investments. Also, the Commission's ordered regression method, combined with the allocation cap, largely nullifies HAI's systematic understatement of costs. Qwest strongly opposes the direct use of any version of HAI to establish costs in Nebraska.

NICE-BCS argues that HAI 5.0a understates costs, and Qwest agrees. They argue that rural LECs face different costs than urban areas, but they do not compare "apples to apples;" Qwest suggests that the proper consideration is that any carrier faces different costs in rural versus urban areas. Qwest, too, serves rural areas in Nebraska, and it faces the same rural costs that HAI fails to properly estimate. Should the Commission adopt NICE-BCS's recommended changes to aerial plant, sharing, and cost of money, Qwest recommends that the Commission make these changes to all carriers based on density.

The Rural Independent Companies suggest using Census data and Map Info software to more accurately measure rural densities. Qwest acknowledges that such a method might produce more precise results, however, the complexities and costs outweigh any possible benefits. It is simply not practical to geocode every location in Nebraska because all underlying data sources contain flawed data. In order to geocode a significant fraction of all homes additional work is, nonetheless, required which is quite difficult and expensive. Qwest recommends that the Commission carefully consider the cost of implementing the Rural Independent Companies' recommendation before pursuing a geocoding approach.

The Rural Independent Companies, on page 8 of their comments, state that the HAI model includes inappropriate costs. Specifically, the Rural Independent Companies

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[1] Qwest is a price cap regulated LEC and therefore has every incentive to operate as efficiently as possible. For this reason, Qwest's recent actual investments in network assets generally reflect an efficient carrier's

advocate reducing or eliminating expenses related to public lines, transport, switching, and operator systems. HAI is a complex model that Qwest does not support, and it is possible to misinterpret its reports. In every case, Qwest considers the Rural Independent Companies to be mistaken in their claims. In the cases of transport, switching, and operator systems, the HAI model assumes factors that allocate a portion of these total expenses to basic local service. In the case of public phones, HAI's results are reduced by the inclusion of these lines. Portions of outside plant are allocated to these lines, reducing the average cost per line in HAI's reports. In any event, the effect of these cost elements is minimal and not discriminatory against any carrier. Considering that HAI will be only used to develop a regression formula, and not direct cost findings, Qwest recommends that the Commission bypass these recommended model adjustments.

ADJUSTMENTS FOR SCALE

The Rural Independent Companies argue for adjustments based on scale. They claim that, because some rural LECs lack buying power, those companies' costs should be increased. Qwest disagrees for two reasons. First, the underlying assumption of forward looking costs is the complete replacement of the network, and the buying power of a rural LEC should only be considered in this context. Even a small rural LEC would enjoy considerable buying power under this scenario. Second, nothing prevents rural LECs from joining together to negotiate favorable terms with vendors. Even products bought in small quantities, such as switches, would be required in large numbers should

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investments.

several rural LECs form a coalition to provide buying power. In the absence of such a coalition, the Rural Independent Companies are really arguing for the need for industry consolidation. If customers can be served better by a smaller number of companies, the Commission should not stand in the way of this efficiency by rewarding rural ILECs' lack of efficient scale. As the Rural Independent Companies' comments show, implementing such cost adjustments is complicated.

The USDA's Rural Utility Service ("RUS") provides low cost loans and grants that reduce the costs of rural ILECs[2]. Qwest recommends that the Commission make no cost adjustments based on scale because doing so is unnecessary and promotes inefficiencies. If, however, the Commission chooses to make adjustments for rural ILECs, Qwest recommends that the Commission also lower the rural ILECs' cost of money and network investments in the model to reflect support from the RUS.

ADVANCED SERVICES

The Rural Independent Companies suggest differentiating support based on the availability of advanced services. Qwest disagrees, as the current Nebraska fund is capped well below the actual support levels required to provide advanced services.

The forward looking assumptions inherent in cost models do not accurately reflect an ILEC's actual cost. Forward looking models generally develop costs below the network costs contained in an ILEC's books. Should the current price of network elements, such as electronics, fall, a forward looking model would not reflect the higher price paid by the ILEC for existing equipment in its network. Forward looking models assume the maximum efficiencies in building the network, not the reality that the ILEC's network was built over many decades. The use of forward looking cost models does not overestimate an ILEC's costs. It is inappropriate to tie Nebraska Universal Service Fund ("NUSF") support to deployment of advanced services, when the theoretical cost basis for the fund tends to understate the cost of basic voice service and includes no advanced service costs.

Even if the fund were sufficient, though, there is no need to condition support based on advanced service availability. If a region demands advanced services and there is sufficient portable support available in the region to support those services, then a carrier will seek to provide advanced services. The NUSF, if sufficient in size and properly constructed, will enable the free market to provide the services rural Nebraskans desire. Qwest recommends that the Commission avoid the complex issue of advanced services. Market forces, combined with a sufficient fund, will spread advanced services across Nebraska without additional government intervention.

TRANSITIONAL PERIOD

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[2] See http://www.usda.gov/rus/telecom/index.htm.

NICE-BCS argues for a transitional or "hold harmless" period to prevent economic shock to regions receiving different support amounts. Should the Commission accept NICE-BCS's arguments, Qwest recommends that the transitional period apply to all carriers, including non-rurals. Non rural carriers face the greatest uncertainty in the amount of support, if any, they will receive. There is no reason not to protect their customers from "rate shock" as well.

OFFSET FOR FEDERAL SUPPORT

Qwest continues to urge the Commission to reduce state NUSF distributions by the amount of Federal intrastate Universal Service ("FUSF") support provided to each ILEC. The savings to the NUSF from this policy can be used to reduce or eliminate the effect of the fund size cap. If the fund size cap is completely eliminated, the FUSF offset savings can be used to reduce the NUSF surcharge rate paid by Nebraskans.

The Order clearly seeks to determine the forward looking cost to provide service based on density. This cost data then determines the total support need for each region. If a ILEC is already receiving intrastate support from another source, such as the FUSF, there is no reason to provide that ILEC more support than the Commission had determined it needs. The FCC has indicated its intention to eventually transform its rural high cost fund from an embedded to a forward looking mechanism. Should this happen, the various amounts each rural LEC receives will change dramatically. A state system that first calculates the total need of an ILEC and then provides for that ILEC's needs beyond what it already receives will serve to smooth this federal transition.

Some parties argue that the FUSF support provided to rural LECs is interstate and therefore not subject to Qwest's proposed FUSF offset. Qwest disagrees with this assertion based on FCC rulings.[3] Based on the most recent Universal Service Administrator Commission ("USAC") report[4], Nebraska rural LECs are expected to receive the following annual FUSF support:

High Cost Loop Support	$13,954,032
Safety Net Additive Support	$216,300
Interstate Access Support	$1,979,172
Long Term Support	$4,055,928
Local Switching Support	$10,878,228
Interstate CL Support	$8,962,696
Total Annual Support	$40,046,356

Of the projected $40 million annual rural FUSF support, $25.9 million is interstate. $13.9 million is essentially an intrastate offset and subject to a NUSF offset per Qwest's recommendation.

[3] See CFR § 36.603 through § 36.605. The support calculation orders do not provide for separation of inter and intrastate costs. This indicates that support is not for interstate only costs. Also see FCC CC Docket No. 96-45 Fourteenth Report & Order ¶ 187 which states that rural support is for intrastate purposes.
[4] http://www.universalservice.org/overview/filings/2003/Q2/

Should the rural ILECs continue to press their claim, and should the Commission adopt their recommendation, two adjustments are necessary. First, in order to receive the allegedly interstate FUSF support, the rural ILECs must be incurring at least that amount of interstate cost. Therefore, any true separation of inter and intrastate costs should allocate at least the FUSF support amount to interstate costs. For rate of return based revenue requirement calculation, therefore, the maximum amount of costs applicable to interstate rate setting should be the total allowable regulated costs less FUSF receipts. Should the Commission allow that FUSF support is interstate, that support amount, at a minimum, should be subtracted from rural ILEC's revenue requirements to avoid double recovery.

Second, when rural ILECs set interstate cost recovery rates, including interstate switched access, the amount of FUSF support should be considered. Rural ILECs, if they insist that FUSF support is interstate only, should not be allowed to double recover their interstate costs through both retail rates and FUSF support. If the Commission accepts the rural ILEC's argument, rural ILECs should be required to demonstrate that interstate retail revenues combined with FUSF support do not exceed interstate costs.

In general, Qwest disagrees with the rural ILEC's assertion that FUSF support is interstate. Qwest considers this support to be intrastate, and any NUSF receipts should be offset by FUSF receipts. If, however, the Commission finds that the rural ILEC's FUSF support is interstate, the Commission should also ensure that the rural ILECs are not double recovering both through FUSF support and through interstate rates.

CONCLUSION

Qwest emphasizes that the purpose of a high cost fund is to benefit rural residents of Nebraska. As long as there is sufficient support to allow an efficient carrier to provide basic local service to rural areas, then that service will be provided – with or without the traditional ILEC's participation. Any attempt to reward companies based on their classification rather than the areas they serve is a distortion of the goal of a high cost fund. Such distortions would institutionalize inefficiencies and block fair competition.

Respectfully submitted this 9th day of May, 2003.

QWEST CORPORATION

By ______________________

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the above and foregoing **QWEST CORPORATION'S REPLY COMMENTS TO PROGRESSION ORDER NO. 4.** was sent via United States first-class mail, postage prepaid, this 9th day of May, 2003 to the following:

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